

# PROPERTY & CASUALTY INSURANCE BROKERAGE REPORT 2019

MANAGING CHANGE: UNCOVERING THE FINANCIAL  
DRIVERS OF THE CANADIAN INSURANCE INDUSTRY

**Smythe**  
ADVISORY



## Smythe LLP Property & Casualty Insurance Report

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## PREFACE

This is the 7th Edition of the *Smythe Property & Casualty Insurance Brokerage Report*. This report will provide you with information on the financial performance of insurance brokerages collected from a Canada-wide sample.

The data for this report was collected from 80 brokerage companies, representing over 250 branches and, what we believe, is the largest available database of independent brokerage financial performance in Canada. The data represents fiscal year-end results between January 2018 and February 2019. This year's report has a focus on independent brokerage companies with number of locations ranging from 1 to 15.

Our report provides information on a variety of current economic trends and conditions in the industry. We have endeavoured to present the information in a meaningful and user-friendly format. However, we understand that the inter-relationship between data may be complex and difficult to understand. We welcome inquiries and comments from readers who require specific data presented in this report.

Our report also contains a significant amount of editorial opinion based on my experience as a Chartered Professional Accountant (CPA), Chartered Business Valuator (CBV) and merger and acquisition (M&A) advisor to the property and casualty (P&C) industry over the past 27 years.

All information provided to us is held in the strictest confidence and is only presented in the aggregate. In some cases, we have excluded data that was unique and, we believed, might have identified participants.

I would especially like to thank the research and financial modelling skills of my colleagues **Gagandeep Ahluwalia**, CPA and **Tim Peters**, CPA. This report would not have been possible without the trust of brokerage owners from across Canada who took the time and effort to complete our survey and provide their financial data.

Sincerely,

**Mike Berris**, CPA, CA, CBV





## ABOUT SMYTHE ADVISORY

Formally established in November 2013, Smythe Advisory is western Canada based with practice locations in Vancouver, Langley and Nanaimo. Smythe Advisory builds upon the business advice and consulting services that Smythe has been providing its accounting clients since the Firm was founded in 1980. In addition to transaction advisory services, Smythe Advisory provides business valuations, financial modelling and corporate finance advisory services to the P&C industry.

Leading the Smythe Advisory practice is Partner, **Mike Berris**, CPA, CA, CBV. Mike has been serving the P&C industry for over 27 years and is recognized as a leading advisor in this field. He frequently speaks to industry groups and contributes articles and papers to various insurance publications.

At Smythe Advisory, our goal is to add value to our clients on every engagement we perform. Our team consists of five qualified Chartered Business Valuators and three analysts.

You can reach Mike directly at **604-694-7548** or [mberris@smythecpa.com](mailto:mberris@smythecpa.com).



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INDUSTRY  
OBSERVATIONS



## P&C INDUSTRY OVERVIEW

P&C insurance is also known as general insurance as it provides protection for a wide array of interests. Property insurance provides financial protection in the event of damage to physical property such as automobiles, buildings or other valuable possessions. Casualty insurance mainly covers legal liability against individuals and organizations for negligent acts or omissions. Insurance is an effective way of spreading risk by having an entire group share the losses of a smaller subset of the group.

P&C companies collect premiums upfront for insuring risks. This pool of funds is used to pay insurance claims and other operating expenses over time. The timing difference in the collection of premiums and the payment of claims and operating expenses creates a capital pool that the insurance companies can invest. A significant portion of profit earned by P&C insurance companies results from investment returns.

## BROKERS' ROLE IN THE P&C INDUSTRY

A broker acts as an intermediary between the customer (individual or business) and the insurance company. The customer is charged a premium for the insurance policy and the premium is paid to either the insurance broker (agency bill) or directly to the insurance company (direct bill). Insurance agents are like brokers; however, they represent a single insurer. Some insurance companies also sell and deliver policies directly to policy holders, known as direct writers. Other key participants in the P&C industry include underwriters, managing general agents (MGAs) and reinsurers. Underwriters

evaluate risks, coverage and premium rates. MGAs generally have access to specialty insurance markets that they make available to brokers for a split of the commission. Reinsurers provide protection against large claims and catastrophic losses that may negatively affect an insurer's financial position.

The bulk of compensation for brokers comes in the form of premium-based commissions, usually a flat percentage of premiums, which varies across lines of business and insurers. The commission typically ranges from 11% to 25% depending on the type of policy purchased. In the case of agency bill, the broker collects the premium and remits to the insurance company net of the agreed commission. In the case of direct bill, the insurance company collects the premium and then pays the broker the commissions earned.

Insurance brokers may also receive contingent profit commission (CPC). CPC is paid if a broker places profitable business with the insurer. CPC is generally calculated based on the percentage of claims paid to premiums earned (earned loss ratio), along with the volume of business placed with the insurer; the lower the earned loss ratio, the greater the CPC. These payments can vary significantly from year-to-year.

While the above outlines the mechanics of the brokers' role, it is important to understand the significance of the customer/broker relationship. In most transactions, the broker plays the role of a "market maker". The broker helps the customer identify their coverage needs and then matches those needs with insurers that have the capability of meeting those needs at the lowest price. While it is natural for an insurance company to want to protect their markets, the brokers' mandate is to represent their customers. The integrity of the competitive bidding process is critically important to the health of the marketplace.



## CANADIAN P&C LANDSCAPE

The P&C market in Canada should be viewed as a mature industry that is highly competitive. With overall industry growth generally tied to gross domestic product (GDP), individual companies are limited in their ability to increase premiums and must grow through either acquisition, or the development of new distribution channels.

Total premiums written in Canada in 2018 was approximately \$68 billion with over 150 companies competing. The top ten underwriters have direct written premiums that account for approximately 59% of the market, which is an increase from 2014 when they controlled 56% of the market. It is also worth noting how companies compare in terms of growing their market share. While the top ten underwriters, as a group, saw a compounded growth rate in premiums of approximately 4.7%, this growth was not shared equally. 2018 was also marked by a hardening market with premium rates rising for most

classes of business. Underwriters have shown significant resolve in obtaining rate increases even if this might impact market share. **1**

While chart 1 indicates premium growth for most industry participants, the overall market is still competitive with no one insurer controlling more than 12% of the market.

The overall market growth has approximated 4.7%<sup>1</sup> over the five-year period ended December 31, 2018. This is marginally higher than the nominal GDP growth rate of 3.8%<sup>2</sup> over the same period.

The Canadian market can be broken into five major lines of business: automobile, personal property, commercial property, liability and other. **2**

1 *MSA 2018 Benchmark Report*

2 *Statista portal 2018*

## INDUSTRY PROFITABILITY

The Canadian P&C industry has consistent profitability with an average pre-tax return on equity over the five years ended 2018 of approximately 8%. The return has primarily been earned from investment income on capital held.

Insurance company underwriting profit is calculated as premiums less claims and underwriting expenses. In a competitive environment, underwriting profit will trend to less than 1% of net premiums. An important key performance indicator (KPI) is the combined ratio, which is the inverse of the underwriting profitability (claims plus underwriting expenses divided by net premiums). The average combined ratio over the five-year period ended 2018 was approximately 98%. This suggests that the industry is competitive, with market forces

keeping premium levels in check. This forces companies to earn profits through their investment portfolios.

As mentioned previously, there was a hardening of the market in the latter half of 2018, resulting in premium rate increases for many classes of business. It remains to be seen how these price increases play out in terms of industry profitability, but it has become evident that underwriters are more than willing to lose premium volume in order to maintain or grow premium rates.

We have summarized various profitability measures in chart 3. **3**

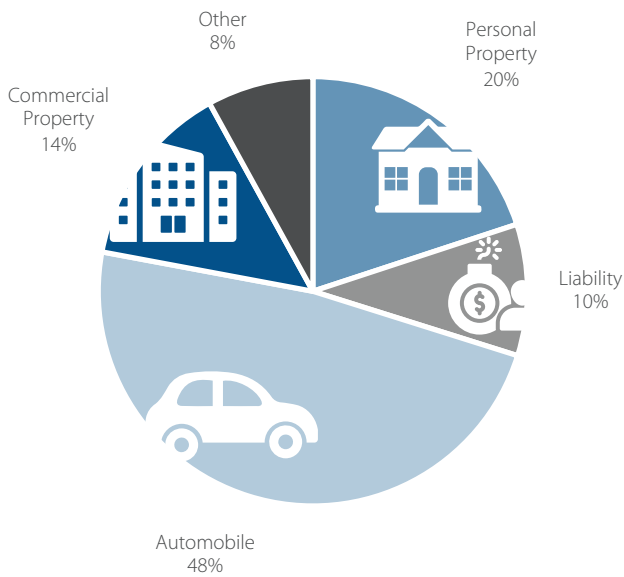


## 1 2018 MARKET SHARE

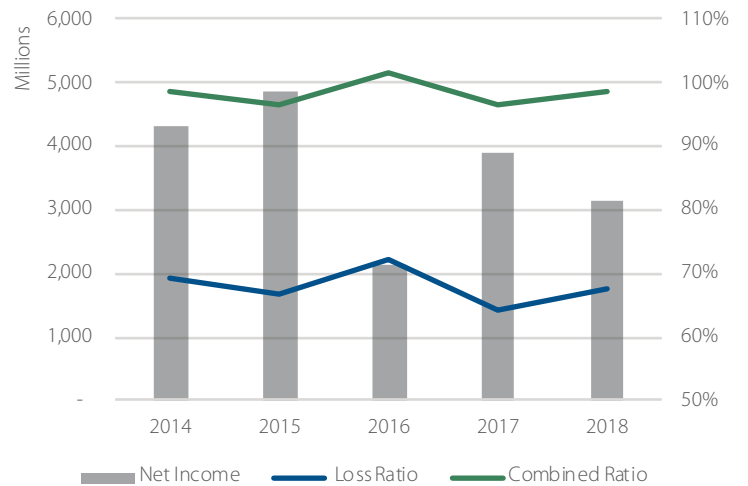
DIRECT WRITTEN PREMIUMS (MILLIONS)	DWP	MKT SHARE	5YR - AVG GROWTH	5 YR - MKT SHARE CHANGE
INTACT	8,534	12.5%	3.1%	-1.3%
AVIVA	5,267	7.8%	5.9%	0.3%
DESJARDINS	4,920	7.3%	17.1%	3.0% *
LLOYD'S UNDERWRITERS	3,491	5.1%	9.6%	1.0%
CO-OPERATORS	3,294	4.9%	6.7%	0.4%
TD INSURANCE	3,185	4.7%	1.2%	-1.0%
RSA CANADA	3,030	4.5%	0.2%	-1.2%
WAWANESA	3,234	4.8%	4.7%	-0.1%
ECONOMICAL	2,456	3.6%	4.6%	-0.1%
NORTHBRIDGE FINANCIAL	1,705	2.5%	7.1%	0.2%
OTHER	28,649	42.3%	4.5%	-1.3%
TOTAL	\$67,765	100.0%	5.1%	0.0%

\* Desjardins acquired State Farm book in late 2014

## 2 CANADIAN MARKET BY LINE OF BUSINESS



## 3 P&C INDUSTRY PROFITABILITY





## DISTRIBUTION CHANNELS

There are three primary distribution channels in Canada: ①

- Insurance brokers who match customers with insurance from multiple insurers;
- Insurance agents who work directly for an insurance company and offer products from that insurer alone; and
- Direct distribution by insurers, usually using the Internet, call centres and affinity programs to reach customers.

In our practice, we have observed what might be described as a blurring of traditional distribution channels. Underwriters are both investing in and purchasing traditional retail brokerages, as well as launching new direct distribution channels. Despite these changes, brokers have continued to hold their own over the past four years, with only a small decline in terms of market share as outlined in the chart to the right. ②

We believe that there is now a form of equilibrium in the market where market participants accept that customers want choices on how they purchase insurance. As long as underwriters distinguish or brand their direct channels separately, brokers are more open to multi-channel distribution by their underwriter partners. Various studies indicate that while customers will utilize various sales channels, a significant

percentage still prefer the professional and personal advice and guidance offered by an insurance broker professional.

One would expect that if direct distribution was materially more profitable, underwriters would be willing to risk alienating their broker channels and use pricing to wrestle more business from the broker; though, this might be easier said than done. We have summarized the 2018 loss and expense ratio information of brokers and direct writers in the chart to the right. ③

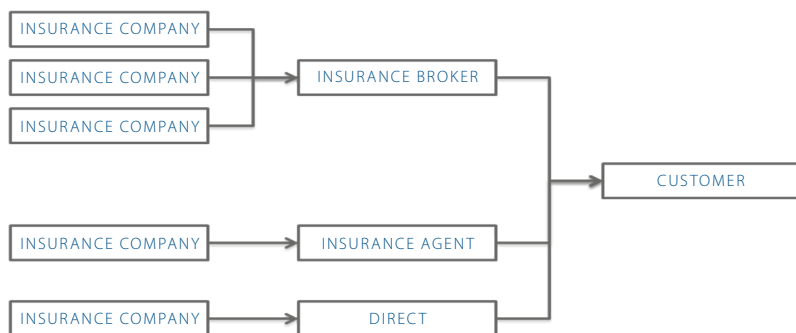
There are a couple of things to keep in mind when looking at the distribution cost of both direct and broker writers. First, while the direct writer does not have to pay brokerage commissions, there are significant acquisition costs, including advertising, processing and customer service. The 2018 and prior year results appear to indicate that the loss ratio is similar among distribution channels, with direct writers having a small advantage in terms of expenses.

If there is any conclusion to be made, it would be that all distribution channels play an important role in the overall P&C insurance distribution chain. Some customers and products are better suited to different distribution methods and each has their advantages and disadvantages.





### 1 INSURANCE DISTRIBUTION CHANNELS



### 3 2018 UNDERWRITER DISTRIBUTION COSTS

	BROKER WRITERS*	DIRECT WRITERS
LOSS RATIO	68.9%	67.7%
EXPENSE RATIO	31.6%	29.0%
<b>COMBINED RATIO</b>	<b>100.5%</b>	<b>96.7%</b>

\* excludes ICBC results

Source: MSA Researcher P&C Software

### 2 DISTRIBUTION CHANNELS

(MILLIONS)	BROKER		DIRECT AND AGENT	
2018	DPW		DPW	
AUTOMOBILE	20,052	62%	12,208	38%
PERSONAL PROPERTY	7,067	53%	6,317	47%
COMMERCIAL AND OTHER	18,063	82%	4,058	20%
	45,182	66%	22,583	34%
2014	DPW		DPW	
AUTOMOBILE	16,054	62%	10,035	38%
PERSONAL PROPERTY	5,452	53%	4,816	47%
COMMERCIAL AND OTHER	15,088	81%	3,464	19%
	36,594	67%	18,315	33%

Source: MSA Researcher P&C Software



## TECHNOLOGY AND MARKET DISRUPTION

Every industry eventually faces some form of disruption. This is typically driven by improvements in technology that either creates, or meets, some need of the consumer. In recent years, we have seen significant market disruptions that have predominately come from companies which have introduced new technological processes. Some notable examples include Apple, Amazon and Uber. Having the ability to recognize the potential disruption, and adapt your business model accordingly, is key to maintaining your position in the marketplace. Companies like Nokia, Sears and Kodak, on the other hand, are examples of great companies that were unable to adjust and paid the ultimate price through insolvency.

Insurance underwriters and brokers are spending millions of dollars attempting to develop technology-driven new or improved distribution channels (InsureTech). While they might not expect to be the next Apple, they certainly want to avoid being the next Nokia. It is our view, that if there is to be industry disruption, it will come in the form of technology-driven improvements that identify likely customers, service existing customers and make improvements to the customer experience during the purchase process. It is beyond our expertise to predict when, or how, this will happen. With that being said, we are

regularly working with brokers who are successfully using some form of InsureTech to improve both market shares and profitability.

InsureTech is already having an impact on the insurance marketplace. Let's look at three new insurance distribution channels that might be classified as InsureTech:

### THE AGGREGATOR

The aggregator could be viewed as the Hotels.com of insurance. Basically, it is a transparent and simple system where customers click on an aggregator site and provide basic information on their insurance needs. The site then displays a range of carriers and prices and allows the customer to directly access the carriers' sites to provide additional information. The aggregator receives a commission and has no further responsibility or involvement with the customer. In this scenario, the aggregator is merely providing another sales channel for the underwriter.

### THE ON-LINE INTERMEDIARY

Second, is what we refer to as an on-line intermediary. We use the term intermediary, rather than broker, because intermediaries tend





to develop an insurance program specific to one underwriter who ensures that the policy wording, rating and underwriting criteria are pre-approved. The intermediary then goes to market, generally with a heavy marketing campaign and variations in offerings, somewhat different from a typical broker or agent.

There are many examples of on-line intermediaries throughout Canada. Like all intermediaries, their ultimate success depends on attracting customers and delivering profitable business to the underwriter. There are brokers who successfully use the on-line intermediary strategy for specialized lines of business. It has been more challenging for brokers to market traditional habitational and commercial business this way.

### **THE INSURETECH DIRECT WRITERS**

In recent years, there have been several very well-financed United States InsureTech direct writers. Examples include Root, Metromile and Lemonade. They have all invested millions in developing their platforms and have enjoyed tremendous market growth. While these companies often package their offerings in a unique manner, their main value proposition is centered around saving money on

insurance. By most accounts, these companies have yet to earn an underwriting profit. While we do not know their strategy, we would not be surprised if the business model was centered around building a premium base which they can then sell to a traditional insurer.

No matter how it is packaged, any potential future disruptions depend on several important factors, which include, but are not limited to, the following:

- Customer and product visibility;
- Ease of purchase;
- Automation, and;
- A customer value proposition.

We believe InsureTech and possible market disruption is one of the driving forces behind the high volume of M&A transactions. Sellers are looking at the high prices being offered and they worry that market disruption might erode their brokerages' value. At the same time, they do not have the resources or organizational energy to make the necessary investments to defend against it. On the other hand, large consolidators require more premiums to create the necessary scale to develop their sales channels and are willing to pay for it.



## TRENDS IN M&A ACTIVITY

The market for P&C brokerages and books of business is strong and will likely continue to be robust in the foreseeable future. Having said that, there are limitations to this growth. Regardless if you are thinking of buying or selling, it is important to understand the dynamics that drive pricing in order to best position yourself in the marketplace.

Looking back to the ten years from 2007 to 2016, we were involved with 13 sell-side transactions with revenue multiples that ranged from 2.1X to 3.5X revenue including contingent commissions. The median enterprise value was 8.0X earnings before interest, tax, depreciation and amortization (EBITDA) or 2.6X revenue. If we assume the EBITDA and revenue multiples are proxies for each other, then this implies an expected EBITDA margin of 30%. In the current M&A environment, we are seeing a wide range of revenue and EBITDA multiples, some of which are significantly higher than the pricing we saw prior to 2017.

In addition to strong prices, deal terms were also tilting in the vendor's favour. For example, earn-outs became less common, working capital targets greater than \$nil were effectively removed and post-closing reps and warranties were less stringent. There was also a lot of competition for brokerages and books of business effectively bidding up prices. Small brokers, regional consolidators, as well as national consolidators were all very active in M&A.

In recent years, we have continued to see prices rise, but it is important to understand the dynamics that have led to the price increases. For the most part, small brokers have been priced out of the market. Regional consolidators are buying when it makes sense but are less active than they were ten years ago. The current market is primarily being driven by underwriters and private equity (PE) investors.

When it comes to P&C brokerage consolidation activity, underwriters have driven the latest round of price increases. Their low cost of capital, and desire to protect premiums revenue, has led to intense competition and record pricing of brokerages and books of business. No one should take this for granted though. Underwriters have become very selective in the type of business they want to take on.

While underwriters have had significant impact on the pricing of P&C books of business, it is our view that PE investors are increasingly becoming significant players, at least as far as new transactions are concerned. In 2017, 604 P&C insurance transactions were announced in the US and Canada. Of these, 382 (this represents over 63%) of them were completed by PE firms or PE-owned brokerages<sup>3</sup>. The PE strategy is different from those of your typical broker or underwriter consolidator and can be very attractive to a vendor in the right circumstances.

In an increasing number of cases, management buyouts or family transitions are taking place. With a proper mix of available capital, creativity and cooperation, this form of transition can be very attractive for brokers who want to start the transition process but are not ready for a complete exit.

Understanding purchaser motivations, who is active in the marketplace and presenting your business in an appropriate manner, is critical in the success of a full, or partial, divestiture process.

<sup>3</sup> *Opis Partners, 2017 Merger & Acquisition Update*



## 1 ESTIMATE OF SIZE OF CANADIAN P&C BROKERAGE COMMISSIONS AVAILABLE

(IN MILLIONS)

PROVINCE	PRIVATE AUTO	PUBLIC AUTO	PERSONAL PROPERTY	COMMERCIAL PROPERTY	LIABILITY AND OTHER	TOTAL COMMISSIONS	MARKET SHARE
Newfoundland and Labrador	48.2		40.2	\$22.5	\$28.6	\$139.5	1.4%
Prince Edward Island	10.8		7.2	6.2	6.9	\$31.0	0.3%
Nova Scotia	69.1		69.1	30.8	48.9	\$218.0	2.1%
New Brunswick	59.5		50.0	25.9	40.8	\$176.1	1.7%
Quebec	421.0		572.6	304.6	366.6	\$1,664.9	16.3%
Ontario	1,503.6		951.9	440.0	1047.2	\$3,942.6	38.7%
Manitoba	1.3	84.5	85.8	57.9	66.4	\$295.9	2.9%
Saskatchewan	127.5	46.3	90.9	85.9	66.2	\$416.8	4.1%
Alberta	508.1		421.5	301.7	364.3	\$1,595.7	15.7%
British Columbia	32.7	434.5	369.8	271.2	370.6	\$1,478.8	14.5%
Yukon	3.6		3.0	2.4	3.4	\$12.4	0.1%
Northwest Territories	2.9		2.7	6.0	3.9	\$15.5	0.2%
Nunavut	0.6		0.5	3.8	1.8	\$6.7	0.1%
Outside Canada	67.9		11.5	41.2	70.5	\$191.2	1.9%
<b>TOTAL</b>	<b>\$2,857</b>	<b>\$565</b>	<b>\$2,677</b>	<b>\$1,600</b>	<b>\$2,486</b>	<b>\$10,185</b>	<b>100%</b>

Source: MSA Researcher P&C Software

Public Insurers Annual Reports

## ESTIMATED MARKET SIZE FOR COMMISSIONS

We have estimated the amount of P&C commissions available to the brokerage industry assuming direct premiums written of approximately \$68 billion and commission data obtained from various sources<sup>4</sup>. The commissions available have been calculated using a commission factor as follows:

- Private automobile: 11%
- Public automobile: Annual Reports
- Personal property: 20%
- Commercial property: 18%
- Liability and other: 21%

Commissions can vary widely depending on the insurance company, use of MGAs, Lloyds, special programs and the negotiating leverage of the brokerage. We compared the derived commissions to actual premium and commission data in our database and found it to be consistent with MSA data indicating net commission expense,

<sup>4</sup> MSA Researcher P&C Software; ICBC, SAF and MPI annual reports and other proprietary data.

excluding CPCs, was approximately \$10.1 billion, or 15% of written premium in 2018<sup>5</sup>.

We have summarized the estimated commissions by line of business and province in chart 1 above. 1

CPC revenue is an important component of brokerage profitability. In 2018, underwriters reported paying approximately \$573 million in CPC.<sup>4</sup> This represents approximately 1% of written premiums, which translates into 7% of total commission income available (excluding public automobile).

It is important for brokers to understand their CPC agreements. Those brokers who deliver a large volume of premiums with consistent underwriting results have more leverage in obtaining a favourable CPC arrangement with underwriters.

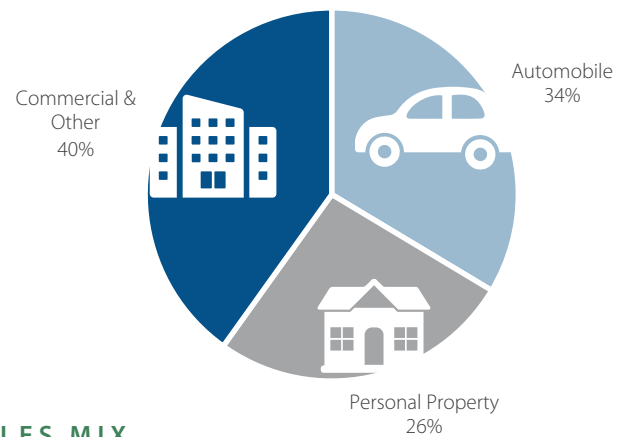
<sup>5</sup> MSA Research P&C Software



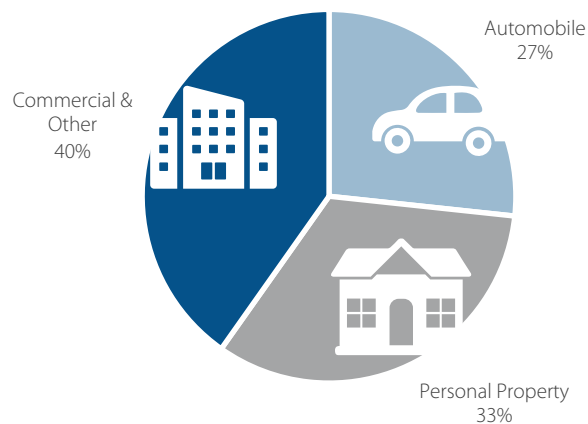
## MARKET COMPOSITION

We have compared our estimated potential comparison of the Canadian commission market sales mix with that of our sample population. We believe our sample is representative of a typical larger retail brokerage. It should be noted that automobile insurance comprises approximately 48% of the premium market, however, lower commission rates reduce its impact on the potential commission revenue sales mix.

## CANADIAN SALES MIX



## 2019 SAMPLE SALES MIX







## EMPLOYEE ENGAGEMENT

As outlined later in this report, employee wages and benefits, on average, represent approximately 75% of the average brokerages' total expenditures, or 55% of revenue earned. The ability to manage individual employee wages is also limited as competition for good staff dictates wages more than your brokerage's specific circumstances.

Much of the data in this report, including labour cost as a percentage of revenue and revenue per employee, are lagging indicators. Employee and customer engagement analysis can together be used to develop both the environment and systems required to improve employee effectiveness.

While employee engagement does not fall within the scope of our professional service offerings, we have seen the positive effect that strong employee engagement has on a brokerage's financial results. There are consulting firms that work with brokerages to improve employee engagement. We have included some material on employee engagement provided by Intellectual Capital Coaching Corporation in Appendix D to this report.

## OUR APPROACH

Our methodology for this analysis of the Canadian P&C insurance brokerage market involved us soliciting brokerages to provide internal operating income statements and to participate in a written survey. In addition, we used data from our proprietary data base.

We received financial information from 80 brokerage companies, with over 250 individual branches or retail outlets. Brokerage revenues ranged from \$600,000 to \$30 million, with operating profit margins from a 4% to 55%. After eliminating outliers, we used 77 companies for our analysis. The fiscal data entered included financial information for 2017 to February 2019 fiscal year ends.

Our objective is to present the data in this report in a clear and unbiased manner. We adjusted the data provided to make it as comparable as possible. Some of the adjustments included:

- Where applicable, head office income and expenses were allocated to branches based on a ratio of branch income to total income.
- EBITDA was considered the best measure of operational performance and we added back interest, amortization and income taxes.
- Where possible, we normalized expenses to exclude non-market expenses and compensation.
- We reclassified certain expenses for sample consistency purposes. Having said that, inconsistent expense allocation is an issue that continues to be a challenge.





2019  
BENCHMARK  
RESULTS



## ① AGGREGATE INCOME AND EXPENSES OF SAMPLE

	2019			2017		
	TOTAL	AVERAGE	%	TOTAL	AVERAGE	%
AUTOMOBILE	91,806,661	1,192,294	24%	62,312,817	519,273	31%
PERSONAL LINES	115,285,838	1,497,219	30%	60,709,419	505,912	30%
COMMERCIAL LINES	142,006,339	1,844,238	37%	66,488,954	554,075	33%
CONTINGENT PROFIT	24,881,145	323,132	6%	10,185,972	84,883	5%
OTHER REVENUE	11,190,634	145,333	3%	3,914,660	32,622	2%
<b>TOTAL INCOME</b>	<b>385,170,617</b>	<b>5,002,216</b>	<b>100%</b>	<b>203,611,822</b>	<b>1,696,765</b>	<b>100%</b>
TOTAL PERSONNEL EXPENSE	211,632,723	2,748,477	55%	110,308,650	919,240	54%
TOTAL PREMISE EXPENSE	19,310,060	250,780	5%	11,788,521	98,238	6%
TOTAL DATA PROCESSING EXPENSE	9,140,672	118,710	2%	3,399,766	28,332	2%
TOTAL MARKETING EXPENSE	9,443,706	122,646	2%	5,616,505	46,804	3%
TOTAL ADMINISTRATIVE EXPENSE	31,948,995	414,922	8%	19,587,684	163,230	10%
<b>TOTAL EXPENSE</b>	<b>281,476,156</b>	<b>3,655,534</b>	<b>73%</b>	<b>150,701,126</b>	<b>1,255,844</b>	<b>74%</b>
<b>OPERATING INCOME</b>	<b>103,694,461</b>	<b>1,346,682</b>	<b>27%</b>	<b>52,910,696</b>	<b>440,921</b>	<b>26%</b>

## OVERALL RESULTS

With a total revenue of approximately \$385 million, we believe our report is representative of the overall Canadian market for privately-owned insurance brokerages.

In our analysis, we have defined and entered data in a manner where operating profit approximates EBITDA. We attempted to measure the core business profitability regardless of special circumstances or capital structure.

The operating profit margin of our sample stood at 27% representing a 1% increase from our 2017 report. Brokers have continued to successfully deal with rising expenses in an era of soft premium rates. Wage expenses continue to rise, increasing by 1% of revenue since our last report, but this has been offset by better expense control.

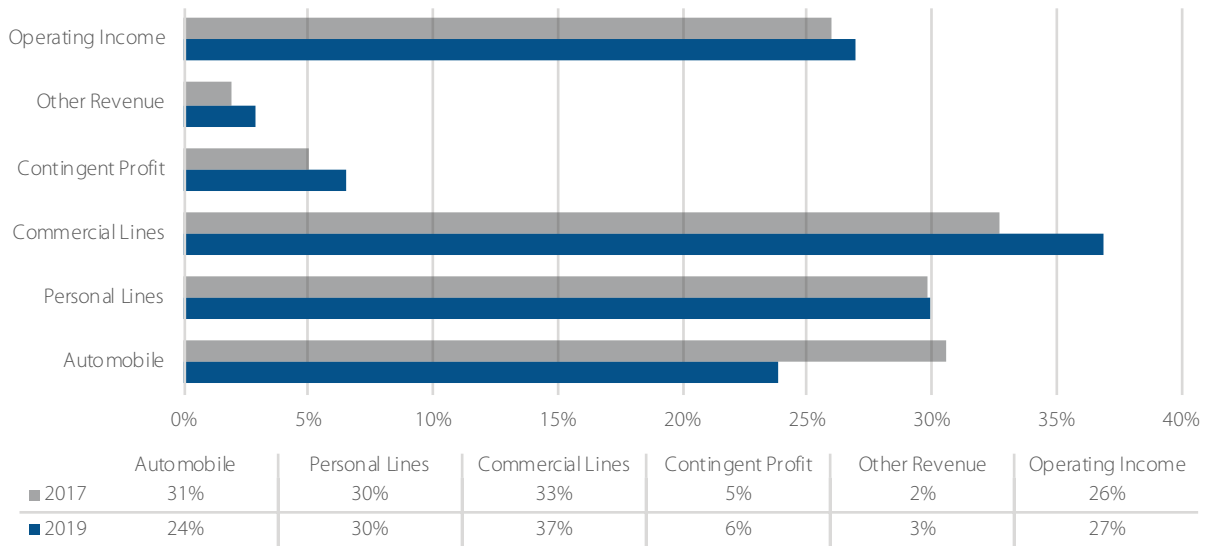
CPCs comprise 6.0% of total revenue and are a significant contributor to overall profit. It should be noted that approximately 1.0% of all premiums collected by Canadian insurers is returned to brokers in the form of contingent profits<sup>6</sup>.

The schedule above provides an aggregation of operating revenue and expenses for the current report and comparative data from our 2017 report. ①

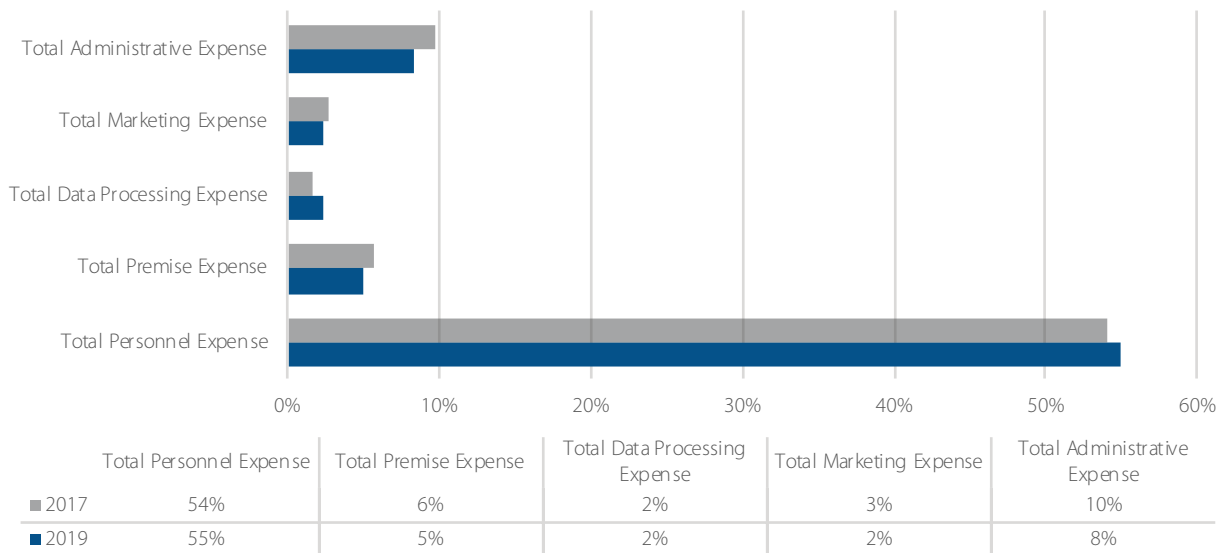
The same data is presented graphically as follows on page 18. ② ③

6 MSA Researcher P&C Software

## ② REVENUE COMPARISON

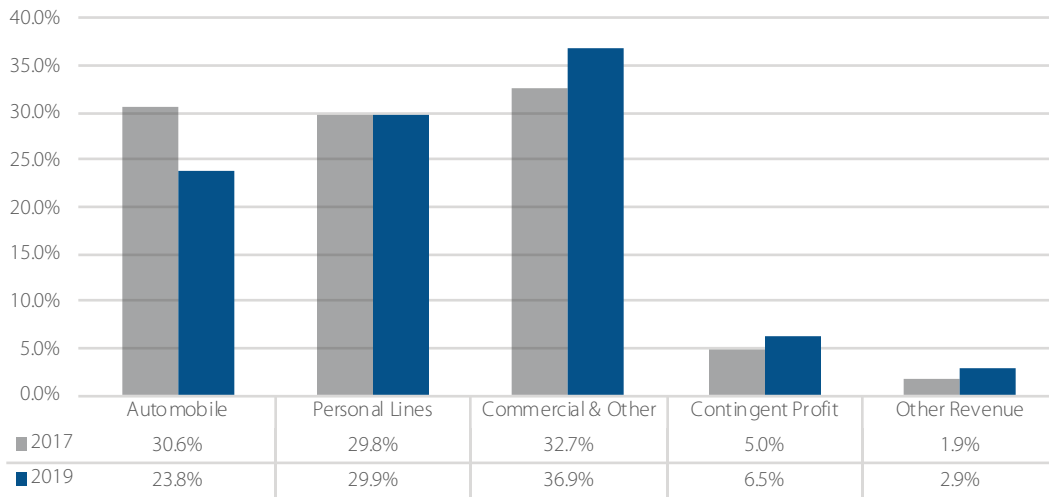


## ③ EXPENSE COMPARISON





## ① TOTAL SALES MIX



## SALES MIX

As mentioned previously, the sales mix in this year's report was more heavily weighted to commercial business. Given the mature state of the industry, commission rates, including over-rides, CPC and other income will play an ever-increasing role in broker profitability. The overall sample sale mix is summarized above. ①

In addition to renewable commission, approximately 9% of income is derived from CPC and other income. As mentioned previously, underwriters are distributing approximately 1% of premiums in the form of CPCs. Assuming an average commission rate of 15%, we would expect that the average broker would have approximately

6.7% of their income in the form of CPCs (1%/15%). Our sample results closely matched the expected results.

While most brokers are challenged to introduce new sources of revenue such as life insurance, premium financing arrangements have proven to be very profitable to those brokers who have the resources and ability to manage it.

It is our view that the sales mix is less important than either the brokers expertise or the ability to develop appropriate systems to efficiently handle the sales volume and mix of business.





## EXPENSE BREAKDOWN

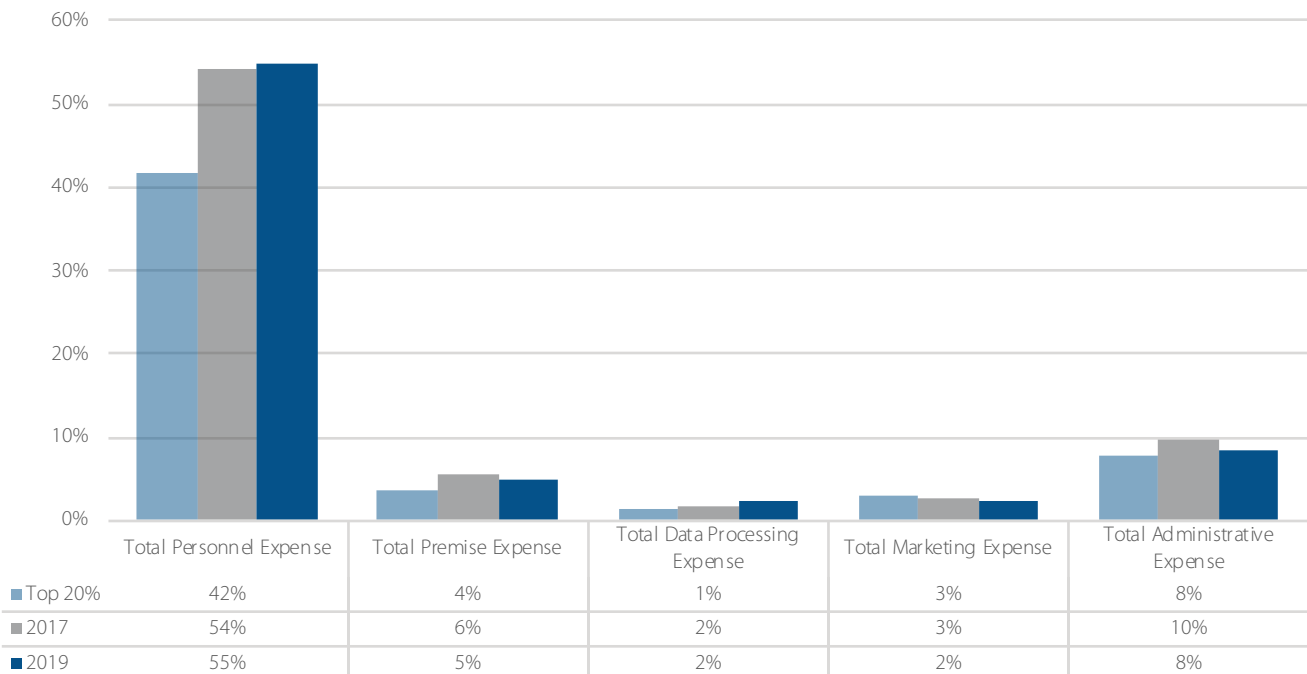
We have categorized brokerage expenses into five categories: personnel, premise, data processing, marketing and administration. The following bar chart breaks down expenses as a percentage of revenue for 2017 and the top performing 20% of brokerages in our sample below. ❶

While systems continue to be improved, the fact remains that labour costs are increasing at a rate greater than commission income. As we say throughout this report, insurance is a mature industry with little growth in premium income and considerable challenges to increase profitability. The brokerage business model is predicated on high

levels of customer service, which requires well-trained staff. Most of our clients have found it challenging to recruit and retain quality people. It is not surprising that wage costs, as a percentage of revenue, have increased to 55% from 48% in 2009. Other expense categories have not varied as significantly over the same period.

The top 20% continue to exercise strong expense control in all categories. As in our previous research, personnel costs continue to be the big differentiator in profitability for the top performers. Wage levels were not lower for the top performers. Instead, we attribute the profitability to employee engagement, scale of offices and systems.

### ❶ TOTAL EXPENSE MIX







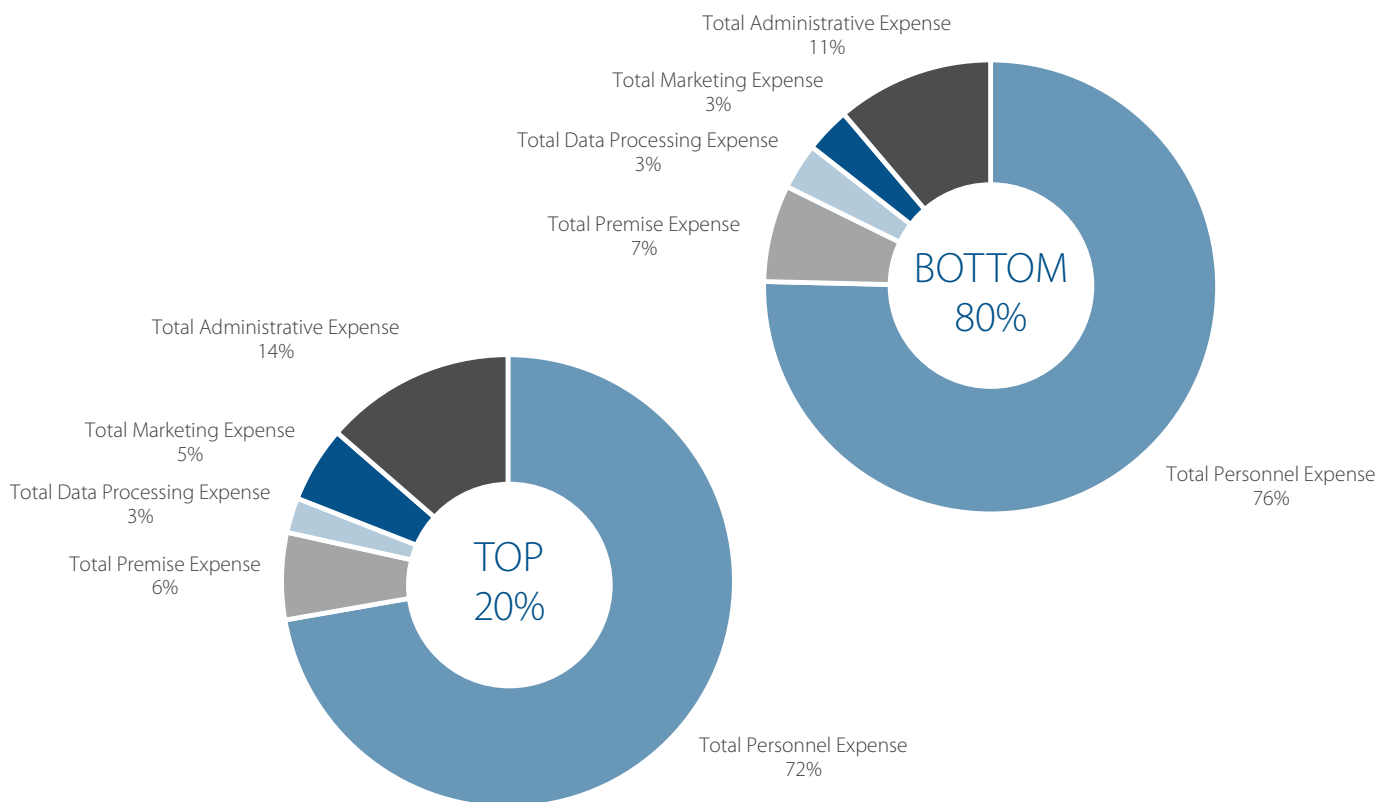
## OVERALL EXPENDITURE INVESTMENT

The below chart outlines the investment of total expenditure dollars to the five expense categories. ❶

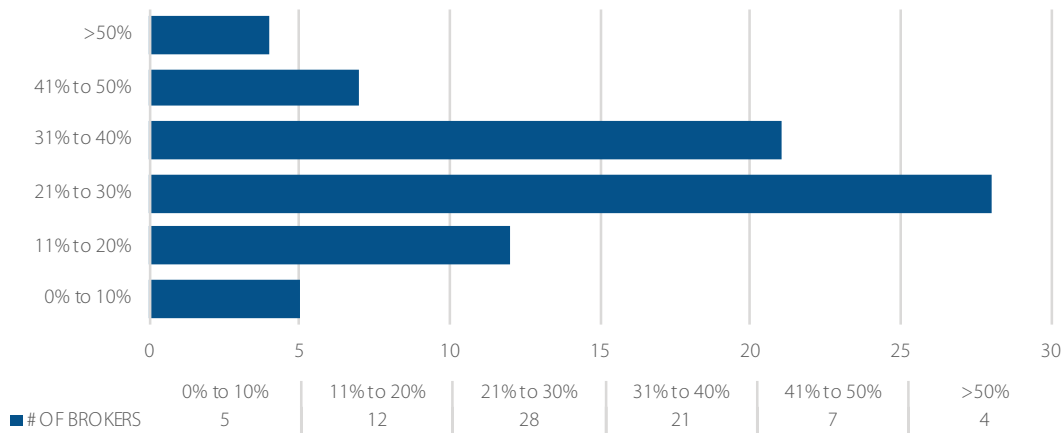
Expense structure has changed little over the past three years. Given the slow growth in Canadian premiums and related broker

commissions, there continues to be the challenge of maintaining profitability, while there is upward pressure on wages. Wages continued to comprise approximately three-quarters of all expenditures with little variance since we published our 2017 report.

### ❶ EXPENSE INVESTMENT AS A PERCENTAGE OF TOTAL EXPENSES



## 1 BROKERAGE PROFITABILITY DISTRIBUTION



## AVERAGE PROFITABILITY

Of the 77 brokerage companies in our sample, the average and median profit levels were 27% and 28% respectively. We have summarized the distribution of our sample by level of profitability. 1

## PROFITABILITY BY BROKERAGE SIZE

Profit distribution by brokerage size is based on sales volume of the brokerage company regardless of the number of branches.

The overall size or scale of a brokerage continues to be a key factor in insurance brokerage profitability. Traditionally, small brokerage offices tend to be profitable as they are directly managed by the owner and are often in smaller communities with lower cost structures. As organizations get larger, there are certain infrastructure costs that must be

put in place. They tend to be fixed in nature but are scalable, resulting in greater profitability as the organization grows.

We also believe management ability becomes crucial as a brokerage grows. Those entrepreneurs who can seek out, attract and then retain top managers are well rewarded.

The chart to the right graphically represents operating metrics of different sized brokerage companies. 2

## PROFITABILITY OF TOP PERFORMERS

In this year's analysis, the top 20% is comprised of the 15 top performing brokers. On average, and as expressed in our previous report, the top 20% performed 17% better than the remaining sample population in terms of operating profit.

We have outlined the results in the chart to the right. 3

We individually reviewed the financial results, as well as provided professional services, to most of the top performers in our sample. While it is difficult to definitively state what makes a top performer, we have noted that many of them possess similar characteristics, that include, but are not limited to, the following:

- Generally, they are focused on commercial lines of business;
- They tend to be single office branches with management depth that extends beyond the broker owner;
- There is a focus on a particular industry classes;
- Sales and operating results are accurately presented and communicated with the team;
- Strong employee engagement;
- Clear and disciplined workflow management;
- A well-defined sales pipeline management process, and;
- Good expense control.



## ② PROFITABILITY BY BROKERAGE SIZE

	SMALL < \$2 million 40 brokerages		MEDIUM \$2 to 5 million 17 brokerages		LARGE > 5 million 20 brokerages	
	2018 TOTAL	% OF REVENUE	2018 TOTAL	% OF REVENUE	2018 TOTAL	% OF REVENUE
AUTOMOBILE	11,594,091	30%	8,832,859	17%	71,379,710	24%
PERSONAL LINES	15,401,312	40%	18,080,693	34%	81,803,834	28%
COMMERCIAL LINES	9,363,825	24%	21,167,109	40%	111,475,405	38%
CONTINGENT PROFIT	1,764,806	5%	2,466,424	5%	20,649,914	7%
OTHER REVENUE	819,113	2%	1,996,185	4%	8,375,335	3%
<b>TOTAL INCOME</b>	<b>38,943,147</b>	<b>100%</b>	<b>52,543,270</b>	<b>100%</b>	<b>293,684,198</b>	<b>100%</b>
TOTAL PERSONNEL	19,196,137	49%	26,111,674	50%	166,324,912	57%
TOTAL PREMISE	1,789,317	5%	2,953,329	6%	14,567,414	5%
TOTAL IT	315,817	1%	846,145	2%	7,978,710	3%
TOTAL MARKETING	900,742	2%	1,177,649	2%	7,365,315	3%
TOTAL ADMINISTRATIVE	4,992,488	13%	5,266,583	10%	21,689,924	7%
<b>TOTAL EXPENSES</b>	<b>27,194,501</b>	<b>70%</b>	<b>36,355,380</b>	<b>69%</b>	<b>217,926,275</b>	<b>74%</b>
<b>OPERATING INCOME</b>	<b>11,748,646</b>	<b>30%</b>	<b>16,187,890</b>	<b>31%</b>	<b>75,757,923</b>	<b>26%</b>

## ③ TOP 20% INCOME AND EXPENSES COMPARISON

	TOP 20%	%	REMAINING	%
AUTOMOBILE	6,319,595	21%	85,487,067	24%
PERSONAL LINES	7,393,204	24%	107,892,634	30%
COMMERCIAL LINES	13,918,124	46%	128,088,216	36%
CONTINGENT PROFIT	1,696,825	6%	23,184,319	7%
OTHER REVENUE	1,012,857	3%	10,177,776	3%
<b>TOTAL INCOME</b>	<b>30,340,605</b>	<b>100%</b>	<b>354,830,012</b>	<b>100%</b>
PERSONNEL EXPENSE	12,613,399	42%	199,019,324	56%
PREMISE EXPENSE	1,084,457	4%	18,225,603	5%
DATA PROCESSING EXPENSE	436,805	1%	8,703,866	2%
MARKETING EXPENSE	947,435	3%	8,496,271	2%
ADMINISTRATIVE EXPENSE	2,375,558	8%	29,573,438	8%
<b>TOTAL EXPENSE</b>	<b>17,457,654</b>	<b>58%</b>	<b>264,018,502</b>	<b>74%</b>
<b>OPERATING INCOME</b>	<b>12,882,951</b>	<b>42%</b>	<b>90,811,510</b>	<b>26%</b>



## CONCLUSION

The results from this year's study indicate that profitability has remained relatively consistent since our last report. Our results show a 1% increase in operating profit.

Labour costs as a percentage of revenue rose almost 1% when compared to the previous report. Historically, we believed larger brokerages were better positioned to manage wage costs due to efficiencies that should come from scale. The results of our sample suggest otherwise, with brokerages with revenues over \$5 million incurring wage costs to revenue of 57% compared to 55% on total sample.

Despite the increase in labour costs, our sample indicates overall expense costs have marginally trended down.

After many years of a soft market, premium rates have risen materially over the past 12 months. While this might appear to be great news for the brokerage industry, it remains to be seen how it plays out. As insurance prices increase, customers tend to review their coverage and deductibles, as well as look for lower cost alternatives.

While significant resources are being invested in online distribution methods, it is our view that smaller brokerages can adapt by using on-line technology being offered by third party providers with the view to protect their market position. We note that the most successful brokerages continue to improve profitability through strong frontline underwriting, development of specialized knowledge and, as always, with expense discipline.

Demand for P&C brokerages continues to be strong, but acquirers are expected to be more strategic in their acquisitions to ensure they can easily be integrated into their operations. Insurance companies and private equity firms will likely continue to dominate M&A activity in the upcoming years.

In closing, we want to be clear that that we are confident the brokerage distribution channel is strong and will continue to be so in the years to come.

## APPENDIX A - AGGREGATE INCOME AND EXPENSES OF BROKERAGES IN 2019 AND 2017

	2019			2017		
	TOTAL	AVERAGE	% OF REVENUE	TOTAL	AVERAGE	% OF REVENUE
AUTOMOBILE	91,806,661	1,192,294	23.8%	62,312,817	519,273	30.6%
PERSONAL LINES	115,285,838	1,497,219	29.9%	60,709,419	505,912	29.8%
COMMERCIAL LINES	142,006,339	1,844,238	36.9%	66,488,954	554,075	32.7%
CONTINGENT PROFIT	24,881,145	323,132	6.5%	10,185,972	84,883	5.0%
OTHER REVENUE	11,190,634	145,333	2.9%	3,914,660	32,622	1.9%
<b>TOTAL INCOME</b>	<b>385,170,617</b>	<b>5,002,216</b>	<b>100.0%</b>	<b>203,611,822</b>	<b>1,696,765</b>	<b>100.0%</b>
SALARIES, WAGES AND BENEFITS	167,768,132	2,178,807	43.6%	92,933,117	774,443	45.6%
COMMISSIONS	43,311,082	562,482	11.2%	16,964,339	141,370	8.3%
RECRUITMENT AND TRAINING	553,509	7,188	0.1%	411,194	3,427	0.2%
<b>TOTAL PERSONNEL EXPENSE</b>	<b>211,632,723</b>	<b>2,748,477</b>	<b>54.9%</b>	<b>110,308,650</b>	<b>919,240</b>	<b>54.1%</b>
RENT	16,560,935	215,077	4.3%	9,799,873	81,666	4.8%
REPAIRS AND MAINTENANCE	1,494,924	19,415	0.4%	1,309,350	10,911	0.6%
UTILITIES	631,585	8,202	0.2%	347,498	2,896	0.2%
OTHER PREMISE	622,616	8,086	0.2%	331,800	2,765	0.1%
<b>TOTAL PREMISE EXPENSE</b>	<b>19,310,060</b>	<b>250,780</b>	<b>5.0%</b>	<b>11,788,521</b>	<b>98,238</b>	<b>5.7%</b>
HARDWARE	4,235,598	55,008	1.1%	1,055,199	8,794	0.5%
SOFTWARE	4,905,073	63,702	1.3%	2,344,567	19,538	1.2%
<b>TOTAL DATA PROCESSING EXPENSE</b>	<b>9,140,672</b>	<b>118,710</b>	<b>2.4%</b>	<b>3,399,766</b>	<b>28,332</b>	<b>1.7%</b>
ADVERTISING	8,607,090	111,780	2.2%	5,223,656	43,530	2.6%
DONATIONS	235,578	3,059	0.1%	49,041	409	0.0%
MEALS AND ENTERTAINMENT	601,038	7,806	0.2%	343,808	2,865	0.2%
<b>TOTAL MARKETING EXPENSE</b>	<b>9,443,706</b>	<b>122,646</b>	<b>2.5%</b>	<b>5,616,505</b>	<b>46,804</b>	<b>2.8%</b>
AUTOMOBILE AND PARKING	1,651,197	21,444	0.4%	1,083,631	9,030	0.5%
BAD DEBT	671,237	8,717	0.2%	520,934	4,341	0.3%
BANK CHARGES	4,962,807	64,452	1.3%	3,827,279	31,894	1.9%
INSURANCE	4,058,728	52,711	1.1%	2,178,323	18,153	1.1%
MEMBERSHIP AND DUES	3,106,283	40,341	0.8%	1,025,919	8,549	0.5%
OFFICE	7,013,844	91,089	1.8%	4,764,303	39,702	2.4%
PROFESSIONAL FEES	5,168,959	67,129	1.3%	2,985,815	24,882	1.5%
TELEPHONE	2,670,157	34,677	0.7%	1,698,124	14,151	0.8%
TRAVEL	2,089,847	27,141	0.5%	1,234,335	10,286	0.6%
OTHER ADMINISTRATIVE	555,937	7,220	0.1%	269,021	2,242	0.1%
<b>TOTAL ADMINISTRATIVE EXPENSE</b>	<b>31,948,995</b>	<b>414,922</b>	<b>8.3%</b>	<b>19,587,684</b>	<b>163,230</b>	<b>9.7%</b>
<b>TOTAL EXPENSE</b>	<b>281,476,156</b>	<b>3,655,534</b>	<b>73.1%</b>	<b>150,701,126</b>	<b>1,255,844</b>	<b>74.0%</b>
<b>OPERATING INCOME</b>	<b>103,694,462</b>	<b>1,346,681</b>	<b>26.9%</b>	<b>52,910,696</b>	<b>440,921</b>	<b>26.0%</b>



## APPENDIX B - OPERATING PROFIT - TOP 20% OF BROKERAGES

	TOP 20% OF BROKERAGES (15)			REMAINING SAMPLE (62)		
	TOTAL	AVERAGE	%	TOTAL	AVERAGE	%
AUTOMOBILE	6,319,595	421,306	20.8%	85,487,067	1,378,824	24.1%
PERSONAL LINES	7,393,204	492,880	24.4%	107,892,634	1,740,204	30.4%
COMMERCIAL LINES	13,918,124	927,875	45.9%	128,088,216	2,065,939	36.1%
CONTINGENT PROFIT	1,696,825	113,122	5.6%	23,184,319	373,941	6.5%
OTHER REVENUE	1,012,857	67,524	3.3%	10,177,776	164,158	2.9%
<b>TOTAL INCOME</b>	<b>30,340,606</b>	<b>2,022,707</b>	<b>100.0%</b>	<b>354,830,012</b>	<b>5,723,065</b>	<b>100.0%</b>
SALARIES, WAGES AND BENEFITS	10,625,925	708,395	35.0%	157,142,207	2,534,552	44.3%
COMMISSIONS	1,934,859	128,991	6.4%	41,376,223	667,358	11.7%
RECRUITMENT AND TRAINING	52,615	3,508	0.2%	500,894	8,079	0.1%
<b>TOTAL PERSONNEL EXPENSE</b>	<b>12,613,399</b>	<b>840,893</b>	<b>41.6%</b>	<b>199,019,324</b>	<b>3,209,989</b>	<b>56.1%</b>
RENT	730,127	48,675	2.4%	15,830,808	255,336	4.5%
REPAIRS AND MAINTENANCE	162,263	10,818	0.5%	1,332,661	21,495	0.4%
UTILITIES	173,891	11,593	0.6%	457,694	7,382	0.1%
OTHER PREMISE	18,177	1,212	0.1%	604,439	9,749	0.2%
<b>TOTAL PREMISE EXPENSE</b>	<b>1,084,457</b>	<b>72,297</b>	<b>3.6%</b>	<b>18,225,603</b>	<b>293,961</b>	<b>5.1%</b>
HARDWARE	238,660	15,911	0.8%	3,996,938	64,467	1.1%
SOFTWARE	198,146	13,210	0.7%	4,706,928	75,918	1.3%
<b>TOTAL DATA PROCESSING EXPENSE</b>	<b>436,805</b>	<b>29,120</b>	<b>1.4%</b>	<b>8,703,866</b>	<b>140,385</b>	<b>2.5%</b>
ADVERTISING	728,530	48,569	2.4%	7,878,560	127,074	2.2%
DONATIONS	48,764	3,251	0.2%	186,815	3,013	0.1%
MEALS AND ENTERTAINMENT	170,141	11,343	0.6%	430,897	6,950	0.1%
<b>TOTAL MARKETING EXPENSE</b>	<b>947,435</b>	<b>63,162</b>	<b>3.1%</b>	<b>8,496,271</b>	<b>137,037</b>	<b>2.4%</b>
AUTOMOBILE AND PARKING	109,091	7,273	0.4%	1,542,106	24,873	0.4%
BAD DEBT	113,282	7,552	0.4%	557,955	8,999	0.2%
BANK CHARGES	336,969	22,465	1.1%	4,625,837	74,610	1.3%
INSURANCE	376,028	25,069	1.2%	3,682,700	59,398	1.0%
MEMBERSHIP AND DUES	125,890	8,393	0.4%	2,980,394	48,071	0.8%
OFFICE	704,085	46,939	2.3%	6,309,759	101,770	1.8%
PROFESSIONAL FEES	283,980	18,932	0.9%	4,884,979	78,790	1.4%
TELEPHONE	164,797	10,986	0.5%	2,505,361	40,409	0.7%
TRAVEL	136,513	9,101	0.4%	1,953,334	31,505	0.6%
OTHER ADMINISTRATIVE	24,924	1,662	0.1%	531,013	8,565	0.1%
<b>TOTAL ADMINISTRATIVE EXPENSE</b>	<b>2,375,558</b>	<b>158,371</b>	<b>7.8%</b>	<b>29,573,438</b>	<b>476,991</b>	<b>8.3%</b>
<b>TOTAL EXPENSE</b>	<b>17,457,654</b>	<b>1,163,844</b>	<b>57.5%</b>	<b>264,018,502</b>	<b>4,258,363</b>	<b>74.4%</b>
<b>OPERATING INCOME</b>	<b>12,882,952</b>	<b>858,863</b>	<b>42.5%</b>	<b>90,811,510</b>	<b>1,464,702</b>	<b>25.6%</b>

## APPENDIX C - AGGREGATE OPERATING PROFIT BY SIZE

	SMALL < 2,000,000 (40)		MEDIUM 2,000,000 TO 5,000,000 (17)		LARGE > 5,000,000 (20)	
	2018 TOTAL	% OF REVENUE	2018 TOTAL	% OF REVENUE	2018 TOTAL	% OF REVENUE
AUTOMOBILE	11,594,091	29.8%	8,832,859	16.8%	71,379,710	24.3%
PERSONAL LINES	15,401,312	39.5%	18,080,693	34.4%	81,803,834	27.9%
COMMERCIAL LINES	9,363,825	24.0%	21,167,109	40.3%	111,475,405	38.0%
CONTINGENT PROFIT	1,764,806	4.5%	2,466,424	4.7%	20,649,914	7.0%
OTHER REVENUE	819,113	2.1%	1,996,185	3.8%	8,375,335	2.9%
<b>TOTAL INCOME</b>	<b>38,943,148</b>	<b>100.0%</b>	<b>52,543,270</b>	<b>100.0%</b>	<b>293,684,199</b>	<b>100.0%</b>
SALARIES, WAGES AND BENEFITS	17,359,023	44.6%	20,282,370	38.6%	130,126,739	44.3%
COMMISSIONS	1,811,379	4.7%	5,790,022	11.0%	35,709,682	12.2%
RECRUITMENT AND TRAINING	25,736	0.1%	39,282	0.1%	488,491	0.2%
<b>TOTAL PERSONNEL EXPENSE</b>	<b>19,196,137</b>	<b>49.3%</b>	<b>26,111,674</b>	<b>49.7%</b>	<b>166,324,912</b>	<b>56.6%</b>
RENT	1,479,183	3.8%	2,069,513	3.9%	13,012,239	4.4%
REPAIRS AND MAINTENANCE	204,230	0.5%	544,181	1.0%	746,513	0.3%
UTILITIES	86,415	0.2%	284,554	0.5%	260,616	0.1%
OTHER PREMISE	19,489	0.1%	55,081	0.1%	548,046	0.2%
<b>TOTAL PREMISE EXPENSE</b>	<b>1,789,317</b>	<b>4.6%</b>	<b>2,953,329</b>	<b>5.6%</b>	<b>14,567,414</b>	<b>5.0%</b>
HARDWARE	191,626	0.5%	344,327	0.7%	3,699,645	1.3%
SOFTWARE	124,190	0.3%	501,818	1.0%	4,279,065	1.5%
<b>TOTAL IT EXPENSE</b>	<b>315,817</b>	<b>0.8%</b>	<b>846,145</b>	<b>1.6%</b>	<b>7,978,710</b>	<b>2.7%</b>
ADVERTISING	770,656	2.0%	914,825	1.7%	6,921,610	2.4%
DONATIONS	55,028	0.1%	64,833	0.1%	115,718	0.0%
MEALS AND ENTERTAINMENT	75,058	0.2%	197,992	0.4%	327,988	0.1%
<b>TOTAL MARKETING EXPENSE</b>	<b>900,742</b>	<b>2.3%</b>	<b>1,177,649</b>	<b>2.2%</b>	<b>7,365,315</b>	<b>2.5%</b>
AUTOMOBILE AND PARKING	191,897	0.5%	187,996	0.4%	1,271,303	0.4%
BAD DEBT	199,671	0.5%	210,982	0.4%	260,584	0.1%
BANK CHARGES	1,001,979	2.6%	774,514	1.5%	3,186,313	1.1%
INSURANCE	427,888	1.1%	600,411	1.1%	3,030,429	1.0%
MEMBERSHIP AND DUES	100,148	0.3%	170,801	0.3%	2,835,334	1.0%
OFFICE	1,360,575	3.5%	1,928,720	3.7%	3,724,549	1.3%
PROFESSIONAL FEES	892,466	2.3%	534,781	1.0%	3,741,712	1.3%
TELEPHONE	264,429	0.7%	355,802	0.7%	2,049,926	0.7%
TRAVEL	360,462	0.9%	241,381	0.5%	1,488,004	0.5%
OTHER ADMINISTRATIVE	192,972	0.5%	261,195	0.5%	101,770	0.0%
<b>TOTAL ADMINISTRATIVE EXPENSE</b>	<b>4,992,488</b>	<b>12.8%</b>	<b>5,266,583</b>	<b>10.0%</b>	<b>21,689,924</b>	<b>7.4%</b>
<b>TOTAL EXPENSE</b>	<b>27,194,501</b>	<b>69.8%</b>	<b>36,355,380</b>	<b>69.2%</b>	<b>217,926,275</b>	<b>74.2%</b>
<b>OPERATING INCOME</b>	<b>11,748,647</b>	<b>30.2%</b>	<b>16,187,890</b>	<b>30.8%</b>	<b>75,757,924</b>	<b>25.8%</b>

## APPENDIX D

### EMPLOYEE ENGAGEMENT – ARE YOU WASTING 37 CENTS OF EVERY PAYROLL DOLLAR

By Rick Bauman – Intellectual Capital Coaching Corporation (IC3)

*The Smythe Property & Casualty Insurance Brokerage Report* contains valuable information to help you understand where you have been and where you are now. For the most part, financial and operational information are lagging indicators which are necessary in order to successfully manage a brokerage.

There is one thing lagging indicators can't do. That is, predict the future. This is where leading indicators such as client engagement and employee engagement analysis play a vital role. If compiled properly, leading indicators can be a strong indicator of expected future performance.

Today's brokerage leaders face some tough challenges, that include, but are not limited to, the following:

- Increased competition that may be all but invisible
- How to deal with digital transformation
- Satisfying well-informed customers
- Pressure for results
- Finding and keeping good staff
- Confusion from information overload
- Crisis of confidence

Typical responses that we see to these challenges are:

- Go harder and/or faster
- Invest in training
- Streamline and improve processes
- Replace people

If you have tried some of these responses, but still have not had the results you expected, it might be time to look for a better way; and that is to listen to the voices of your clients and employees.

If you survey your clients and find they are highly engaged, great! You can look forward to:

- Higher retention
- Higher revenue per client
- A steady flow of referrals

On the other hand, if your clients' level of engagement is on the lower end, their business may be vulnerable to an offering from competitors or a market disruptor.

At IC3, our focus is on employee engagement. If your people become more engaged, you will enjoy:

- Lower turnover of your best people
- Happier, more loyal clients
- Higher productivity and profitability

If you have compared your lagging indicators to the data in Smythe's report and have concluded you want better results, focusing on employee engagement is a good place to start. Highly engaged employees have a real desire to better serve your customers. They enjoy coming to work and are more satisfied professionally.

Unfortunately, most employees are not engaged. In a recent Gallup report<sup>7</sup> on employee engagement, they contend that over 85% of employees are either totally or partially disengaged from their work.

Resource Development Systems translated earlier but similar Gallup data into an estimated Payroll Efficiency Factor of 63%.<sup>8</sup> In

other words, the typical employer might be wasting 37 cents of every payroll dollar due to disengaged employees.

While this is not good news, the Gallup's Harter goes on to tell us, "when compared with business units in the bottom quartile of Gallup's database, those in the top quartile of engagement realize 10% higher customer metrics, 17% higher productivity, 20% higher sales and 21% higher profitability. Organizations at the top achieve earnings per share growth that is more than four times that of their competitors."

At Intellectual Capital Corporation (IC3) we work with P&C brokerages to identify problems with employee engagement and help management develop actionable plans to improve engagement and financial results.

Our process involves the following steps:

- Conducting an anonymous employee survey specifically designed for brokerages;
- Helping management understand the issues before conducting employee debriefing sessions to learn what is behind the survey results.
- Developing an action plan with input from both employees and management;
- Ensuring the action plan is executed with regular employee feedback,
- Adjusting the plan as needed.

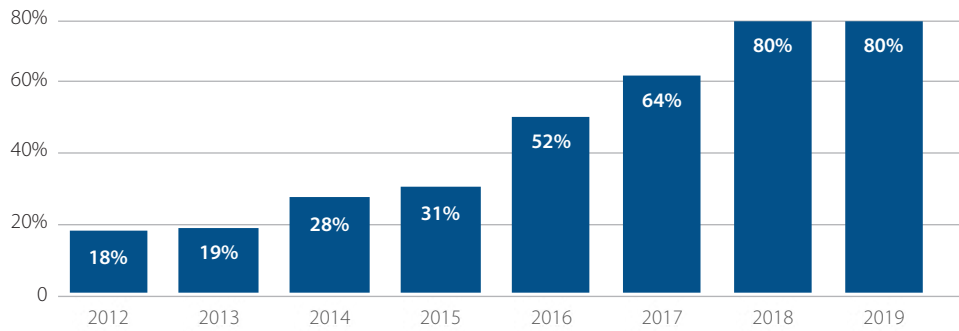
The process to increase employee engagement takes time, but the process can make a significant difference to your overall financial performance. Our track record over the past eight years is outlined to the right.

<sup>7</sup> *Dismal Employee Engagement Is a Sign of Global Mismanagement* – Jim Harter, Gallup Corp

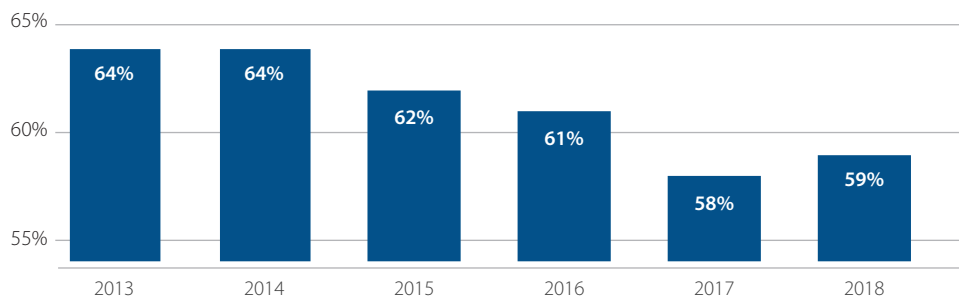
<sup>8</sup> *The Myth of Mediocrity* – Resource Development Systems LLC



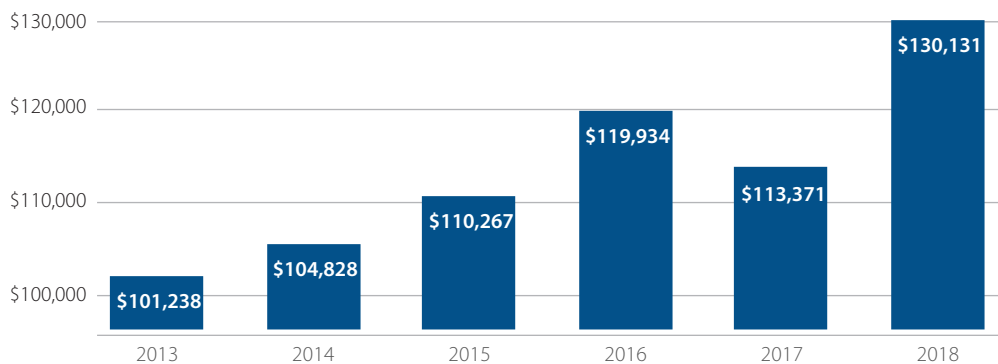
### ① OVERALL NET ENGAGEMENT



### ② COMPENSATION COSTS AS A % COMMISSION



### ③ COMMISSION PER EMPLOYEE



On average, we have been able to increase overall net engagement from 18% to 80% since the inception of IC3 to present. ①

Employee cost as a percentage of renewable commissions drops from 64% to 59% over the same eight-year period. ②

Average renewable commissions per employee also increased from approximately \$101,000 to \$130,000. ③

For more information on our employee engagement improvement process, contact **Rick Bauman** at IC3 at Capital Coaching Corporation at [rick@ic3.ca](mailto:rick@ic3.ca)



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